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IN THE

Supreme Court of the United States

No. 71-1194

QUINN AND COMPANY, INC., and JOHN DORNACKER,

Petitioners,

—against—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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No. .....

QUINN AND COMPANY, INC., and JOHN DORNACKER,

Petitioners,

—against—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners, Quinn and Company, Inc., and John Dornacker, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit (the "Court of Appeals") entered on December 17, 1971, affirming an administrative order (the "Suspension Order") against Petitioners by the Securities and Exchange Commission (the "Commission").

Citation to Opinion Below

The opinion of the Court of Appeals affirming the Suspension Order is reported in 452 F.2d 943 (1971) and is printed in Appendix A hereto.

Statement of Jurisdiction

On January 25, 1971, the Commission issued its Findings and Opinion and the Suspension Order (Appendix B at 6a) pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78o(b), o-3, s(a)(3). The Commission on January 29, 1971, stayed the effectiveness of the Suspension Order and has entered no further order related thereto.

The Court of Appeals reviewed the Suspension Order pursuant to Section 25(a) of the 1934 Act, 15 U.S.C. § 78y(a).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented for Review

1. Did the Court of Appeals, in holding that Petitioners' customer, Ted M. White ("White"), was a statutory "underwriter" as defined in Section 2(11) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77b(11), erroneously decide an important question of federal securities law contrary to this Court's decision in *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953)?

2. Did the Court of Appeals, in denying applicability to Petitioners of the exemptions from registration for transactions by a dealer and for brokers' transactions contained, respectively, in Sections 4(3) and 4(4) of the 1933 Act, 15 U.S.C. § 77d(3),(4), erroneously decide an important federal question which has not been but should be settled by this Court?

Federal Statutes, Rules and Regulations Involved

The statutes involved include the 1933 Act, 15 U.S.C. § 77a *et seq.*, pertinent parts of which are set forth in Appendix C because of length as follows:

Section 2(3), 15 U.S.C. § 77b(3)
Section 2(11), 15 U.S.C. § 77b(11)
Section 2(12), 15 U.S.C. § 77b(12)
Section 3(a)(9), 15 U.S.C. § 77c(a)(9)
Section 4(1), 15 U.S.C. § 77d(1)
Section 4(3), 15 U.S.C. § 77d(3)
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Section 5(a), 15 U.S.C. § 77e(a)
Section 5(c), 15 U.S.C. § 77e(c)
Section 6(a), 15 U.S.C. § 77f(a)
Section 17(a), 15 U.S.C. § 77q(a)

Sections 10(b), 15(b)(1)-(10), 15A(*l*)(1)-(3), 19(a)(3) and 25(a) of the 1934 Act, 15 U.S.C. §§ 78j(b), o(b)(1)-(10), o-3(*l*)(1)-(3), s(a)(3), y(a), and 28 U.S.C. § 1254(1) are also involved and are also set forth in Appendix C.

Statement of the Case

A. Procedural History

On April 21, 1969, the Commission instituted private agency proceedings alleging that Petitioner Quinn and Company, Inc. ("Quinn Inc."), Petitioner John Dornacker ("Dornacker") and 25 other respondents had violated the registration provisions of Sections 5(a) and (c) of the 1933 Act, 15 U.S.C. §§ 77e(a),(c), in connection with offers to sell, sales and deliveries after sale of stock of Mountain States Development Company, Inc. ("Mountain").

Quinn Inc., Dornacker and the Commission's Division of Trading and Markets subsequently entered into a Stipulation which, together with accompanying exhibits, constituted the full and entire record for the Commission's determination of its agency proceedings as to Quinn Inc. and Dornacker. On January 25, 1971, the Commission (without testimonial hearing) issued its Findings

and Opinion and its Suspension Order which were based solely upon the stipulated record. In its Findings and Opinion (Appendix B at 6a), the Commission concluded that White was a statutory "underwriter" under Section 2(11) of the 1933 Act, 15 U.S.C. § 77b(11), and that Quinn & Co., a partnership predecessor of Quinn Inc., and Dornacker had willfully violated the registration provisions of Section 5 of the 1933 Act, 15 U.S.C. § 77e. By its Suspension Order (Appendix B at 22a), the Commission suspended Quinn Inc. from membership in the National Association of Securities Dealers, Inc., for 15 days and Dornacker from association with any broker-dealer for 20 days.

On December 17, 1971, the Court of Appeals affirmed the Commission's Order. Petitioners seek certiorari from the judgment of the Court of Appeals.

B. The Facts

The record before the Court of Appeals was the stipulated record previously before the Commission. The stipulated record included the following facts, many of which were not referred to or discussed by the Court of Appeals in its opinion.

1. The Graham-Mountain Scheme

Commencing with the acquisition of control over Mountain by one Charles Graham ("Graham"), Mountain, Graham and others (not including White) after July 16, 1967, engaged in a fraudulent scheme in violation of Section 17 of the 1933 Act, 15 U.S.C. § 77q, and Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b). The scheme continued until at least August 22, 1968.

The scheme involved (1) manipulation of the price of Mountain's stock through issuance of false and misleading shareholder reports, letters and a press release; (2) sale to brokers and members of the investing public

of large portions of unregistered Mountain stock at substantial profits; (3) control of the stock transfer operations of Mountain to facilitate transfer and sale of unregistered stock; (4) Mountain's failures to report to the Commission transactions, increases in its securities outstanding and stock sales of its affiliates as required by the 1934 Act; and (5), to the extent reports under the 1934 Act were filed, inaccurate or untimely reports of relevant transactions by Mountain or its affiliates.[1] During continuance of the scheme, Mountain issued at least 2,486,801 shares (including shares issued to White), an amount almost equal to the entire stock of Mountain outstanding (2,982,915 shares) as of December 31, 1967.

2. The Graham-Mountain-White Transaction

White was never a director, officer or person controlling or otherwise affiliated with Mountain. White had no relationship to Mountain or its affiliates except as the holder of 37,000 of Mountain's shares which he acquired from Mountain, while the scheme was in progress, as a result of a transaction initiated by Graham in the summer of 1967. In the transaction, Graham on Mountain's behalf orally offered and sold to White an indefinite number of Mountain's shares which, together with some cash and other considerations, were to be delivered to White in exchange for transfer to Mountain of White's electric logging equipment and interests in certain producing gas wells. The equipment and gas well interests had an agreed value of at least $16,000.

White agreed to Graham's proposal, physically delivered the equipment to Graham and notified the operator of the gas wells that his interests therein were being

[1] The description of the scheme is based on the Commission's allegations in a civil action against Mountain, Graham and various other defendants (not including White, Quinn Inc. or Dornacker). By terms of the Stipulation, the Commission's allegations may be deemed to be true.

assigned to Mountain. White and Graham subsequently confirmed the transaction in writing on or about September 12, 1967. Mountain did not issue certificates to White until May 1, 1968, when it delivered to White certificates for 37,000 shares. The shares represented less than 1 percent of Mountain's stock outstanding either before or after such issuance.

3. Material Misstatements and Omissions in the Sale of Mountain's Stock to White

In the transaction with White, Graham falsely stated that he was in the process of obtaining "SEC approval" for delivery of Mountain's stock to White and that the stock would be delivered to White only after such "SEC approval" had been obtained. Mountain in fact had not filed any registration statement under the 1933 Act, and none was ever in effect. White was willing to accept Mountain's stock only if it was readily salable.

White was not a college graduate. His education beyond high school included no business courses and was limited to some architectural and engineering courses. His business experience was limited essentially to self-employment in drilling oil and gas wells. He had no prior experience in Securities and Exchange Commission matters, the promotion of a company or the issuance of securities in exchange for property. He had never been a party, witness or involved in any way in any investigation by the Commission or in any filing or other dealing with the Commission. White was entirely ignorant of any restriction upon his resale of the shares. Neither Mountain, Graham nor anyone else informed White that there were any possible restrictions, legal or otherwise, upon his resale of his Mountain stock even though White told Graham that he intended to resell the stock through a broker.

The stipulated record contains no evidence, moreover,

that White, at any time, requested or received any information regarding the financial condition of Mountain, the results of its operations, material transactions between Mountain and its affiliates, the fraudulent scheme involving Mountain and others in progress after July 16, 1967, or the manipulative effect of the scheme. Not being a director, officer or controlling person of Mountain, White never had access to, and was not provided with, material information comparable to that which would have been available to him as a purchaser pursuant to an effective registration statement under the 1933 Act.

4. Activities of Quinn Inc.'s Predecessor and Dornacker in Connection With Sale of White's Mountain Shares

During the period May 8 through August 8, 1968, Quinn & Co., acting as White's agent in brokerage transactions pursuant to his unsolicited order, executed sales in the securities markets for White's account of 25,000 shares of his Mountain stock. Dornacker acted on behalf of Quinn & Co. in the sales of White's stock. Quinn & Co. remitted to White all net amounts owing to him upon all such sales. On September 12, 1968, Mountain's transfer agent advised Quinn & Co. that certificates evidencing 8,000 of White's shares which had been presented to Mountain for transfer in July and August 1968 could not be transferred without compliance with the rules and regulations of the Commission. Quinn & Co. thereafter obtained cancellations of sales of 3,000 shares.

In connection with the White transactions, Quinn & Co. charged White commissions which did not exceed the brokerage commissions and charges which are usual and customary in similar transactions.

Reasons for Granting the Writ

I

CERTIORARI SHOULD BE GRANTED TO REVIEW THE HOLDING OF THE COURT BELOW THAT WHITE WAS AN "UNDERWRITER" AS DEFINED IN SECTION 2(11) OF THE 1933 ACT, 15 U.S.C. § 77b(11), BECAUSE THE HOLDING ERRONEOUSLY DECIDED IMPORTANT FEDERAL QUESTIONS CONTRARY TO THE DECISION OF THIS COURT IN *SEC v. RALSTON PURINA CO.*, 346 U.S. 119 (1953).

The stipulated record compels the inference that Graham and Mountain fraudulently sold Mountain's shares *to White* in violation of Sections 5 and 17(a) of the 1933 Act, 15 U.S.C. §§ 77e,q(a). In its opinion below, the Court of Appeals ignored such violations and the legal significance thereof. The Court of Appeals simply concluded that White was a statutory "underwriter" under Section 2(11) of the 1933 Act, 15 U.S.C. § 77b(11), and that, therefore, resales of his shares were not exempt from registration under Section 4(1) of the 1933 Act, 15 U.S.C. § 77d(1), as "transactions by any person other than an issuer, underwriter, or dealer." (Appendix A at 3a.)[2] In effect, the Court of Appeals determined that White was one who "sponsors the investment of other people's money" (*H.R. Rep. No. 85*, 73d Cong., 1st Sess. 3 (1933)); that he was not a member of the class which the 1933 Act seeks to protect; and that he (and brokers acting for his account) should be subject to the burdens of the 1933 Act's registration requirements.

[2] The opinion of the Court of Appeals states that the "central issue" was whether White was a statutory "underwriter" with respect to "the 25,000 shares of unregistered Mountain stock that *Dornacker* sold through *Quinn and Company, Inc.* (*Appendix A* at 2a) (*emphasis added*)) Presumably the reference is to sale of the shares by White (not Dornacker) through Quinn & Co. (not Quinn Inc.). Quinn & Co. was a partnership predecessor of Petitioner Quinn Inc. Dornacker was a partner in Quinn & Co. and is an officer of Quinn Inc. Dornacker acted on behalf of Quinn & Co. in connection with resale of White's shares.

A. Under the standards of *Ralston Purina*, individuals like White are members of the "public" entitled to the 1933 Act's protections in any "distribution" to them.

In *SEC v. Ralston Purina Co.* this Court stated:

> . . . The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. The natural way to interpret the private offering exemption is in light of the statutory purpose. Since exempt transactions are those as to which "there is no practical need for . . . [the Bill's] application," the applicability of Section 4(1) should turn on whether the particular class of persons affected need the protection of the Act.
>
> . . . .
>
> . . . [T]he statute would seem to apply to a "public offering" whether to few or many.
>
> . . . .
>
> . . . The focus of inquiry should be on the need of the offerees for the protections afforded by registration. The employees here were not shown to have access to the kind of information which registration would disclose.

SEC v. Ralston Purina Co., 346 U.S. at 124-27.

It is unreasonable to assume that none of the 1,088 employees (*see SEC v. Ralston Purina Co.*, 346 U.S. at 121) buying stock from Ralston Purina over a four-year period necessarily purchased with no intention of resale in the public market. There is no indication in the *Ralston Purina* opinion that any of the 1,088 employees should be deemed to be "underwriters" whose resales of shares through brokers were restricted or involved further violations such as the Commission sought to restrain. The reasonable interpretation of that opinion is, instead, that

the sales to the employees constituted an illegal "distribution" to "public" investors irrespective of their resale intentions.

If uninformed individuals like White have been fraudulently induced to purchase small amounts of securities sold to them in violation of Sections 5 and 17(a) of the 1933 Act, 15 U.S.C. §§ 77(e), q(a), such individuals, under *Ralston Purina* standards, should be deemed to be members of the "public" (notwithstanding their intention to resell) to whom a "distribution" has been made. Particularly should such result follow in respect to White, who lost control over his property months before Mountain issued shares to him and, in contrast to being merely a conduit, assumed financial risks involving thousands of dollars. *Ralston Purina* would have required application of its standards and tests to Mountain's sale to White if White had been an employee of Mountain instead of a stranger to Mountain and its illegal scheme. White should be entitled as a person other than an issuer, underwriter or dealer to the exemption contained in Section 4(1) of the 1933 Act for his subsequent resale.[3]

Contrary to the standards set forth in *Ralston Purina,* the Court of Appeals in its opinion did not focus any inquiry on White's need for the protections afforded by registration. The Court of Appeals did not mention the apparent violations of Sections 5 and 17(a) of the 1933 Act, 15 U.S.C. §§ 77e, q(a), in Mountain's sale to White. The Court of Appeals gave no explicit consideration to

[3] Contrary to the statement in the opinion of the Court of Appeals (*Appendix A* at 3a), Petitioners did not and do not argue that the Mountain-White transaction should be exempt under 15 U.S.C. § 77d(1). Indeed, Petitioners argue and have argued just the reverse, *i.e.*, that Mountain's sale to White was not exempt from the registration requirements of the 1933 Act; that no exemption from such requirements was found by either the Commission or the Court of Appeals; that the sale from Mountain to White was in violation of the registration requirements and anti-fraud prohibitions of the 1933 Act; that White is a member of the investing public under *Ralston Purina* standards; and that the sale from Mountain to White constituted a "distribution" to him.

whether White was powerless to effect or compel registration or to whether the clause "[u]nless the context otherwise requires . . . ," which introduces all definitions in Section 2 of the 1933 Act, prevents application of the Section 2(11) definition to White in the context here presented. The Court of Appeals ignored any fraud in Mountain's sale to White and, focusing only on White's subsequent resale, held that any person otherwise unrelated to an issuer who buys an insubstantial amount of securities from such issuer with an intent to resell buys with "a view to . . . distribution" and is an "underwriter." *But cf. Lively v. Hirschfield,* 440 F.2d 631 (10th Cir. 1971); *Can-Am Petroleum Co. v. Beck,* 331 F.2d 371 (10th Cir. 1964).

B. The 1933 Act's legislative history demonstrates that Congress intended to protect individuals like White and not to impose an impossible registration requirement upon insignificant redistributions by persons not controlling the issuer.

Upon enactment of the 1933 Act, the Committee on Interstate and Foreign Commerce of the House of Representatives stated that the ends to be achieved by the bill included a "demand that the persons, whether they be directors, experts or underwriters, who sponsor the investment of other people's money should be held to high standards of trusteeship." *H.R. Rep. No. 85,* 73d Cong., 1st Sess. 3 (1933). Uninformed individuals like White are the beneficiaries of that demand.

The House Committee also made clear that the demands of the bill "call for the assumption of no impossible burden . . . ." and that the bill did not "affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering." *H.R. Rep. No. 85,* 73d Cong., 1st Sess. 5 (1933). The stipulated record below discloses no meaningful sense in which Petitioners' customer,

White, was responsible for Mountain's massive distribution of unregistered securities, which included the securities distributed to White. White utterly lacked controlling power or influence in respect to Mountain.

In discussing the functions of the last sentence of the Section 2(11) definition which makes controlling persons equivalent to "issuers" for purposes of the definition, the House Committee specifically focused on the 1933 Act's application to "redistributions" by persons other than the issuer:

> Its [the last sentence of the definition] second function is to bring within the provisions of the bill redistribution whether of outstanding issues or issues sold subsequently to the enactment of the bill. All the outstanding stock of a particular stock corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities. Wherever such a redistribution reaches significant proportions, the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill. This being so, the distributor is treated as equivalent to the original issuer and, if he seeks to dispose of the issue through a public offering, he becomes subject to the act.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 13-14 (1933).

The issuer alone can file the required registration statement. Section 6(a) of the 1933 Act, 15 U.S.C. § 77f(a). In the face of compelling, uncontradicted evidence in the stipulated record that White note only lacked control of Mountain but also had been a victim of violation by Mountain and Graham of both the registration and antifraud provisions of the 1933 Act, the holding of the Court

of Appeals that White was a statutory "underwriter" under Section 2(11) appears unique.

C. Indiscriminate or mechanical application of the Section 2(11) definition to all non-controlling individuals purchasing securities from an issuer with the intention of public resale is not contemplated by the 1933 Act.

The definition of "underwriter" could not have been intended to apply literally to *every* situation in which an individual buys directly from an issuer with an intent to resell. For example, Section 3(a)(9) of the 1933 Act, 15 U.S.C. § 77c(a)(9), exempts from registration "[a]ny security exchanged by the issuer with its security holders exclusively when no commission or other remuneration is paid or given directly or indirectly for soliciting such change . . . ." Technically, each exchange is comprehended by the definition of "sale" in Section 2(3), 15 U.S.C. § 77b(3), and involves the "sale" of the new security for property, namely, the old security. It is inconceivable that each such exchange, particularly if involving several thousand security holders, necessarily will not involve some holders who acquire the new security with a view to resale. To call any such holder an "underwriter" would, as a practical matter, negate the exemption. *See* 1 Loss, *Securities Regulation* 583, 642 (2d ed. 1961).

Similarly, offerings by an issuer directly to the public through rights or otherwise, even if made pursuant to a 1933 Act registration statement, as a practical matter cannot and do not involve a detailed inquiry as to the resale intentions of each purchaser of an insubstantial amount of securities. Moreover, all publicly held convertible debentures, warrants, options or similar securities technically involve, in the event of exercise of the conversion privilege or right by the holder, a purchase of a new security directly from the issuer. If in any or all cases the holders exercising such a privilege or right automatically become "underwriters" when they do so

with a view to resale of the new security, the registration requirements of the 1933 Act become completely unworkable.

As the foregoing examples illustrate, non-controlling individuals may, and commonly do, acquire small amounts of a security directly from the issuer under circumstances such that they may be "underwriters" if the Section 2(11) definition is pressed to its literal extreme. A formalistic literal application of the definition to them frustrates and confuses the intention that the 1933 Act "call[s] for the assumption of no impossible burden" and does not affect redistributions of securities except "by reason of the control of the issuer by those responsible for the offering." *H.R. Rep. No. 85,* 73d Cong., 1st Sess. 5 (1933).

D. Applicability of the Section 2(11) definition should not result merely from an intent to resell securities publicly in the absence of a "distribution" of significant proportions by persons able to effect registration.

The 1933 Act contemplates a demarcation between purchasers from an issuer who are "underwriters" and those who are not. In analyzing the related issue of whether an investor who purchases from an affiliate is an "underwriter," Professor Loss has stated:

> On the other hand, the ordinary investor who buys directly from the affiliate is not an "underwriter" *even if he takes for resale.* It should hardly be necessary to point this out except that such a person who takes even a few shares for resale in the market does in a sense buy with a view to their "distribution" within the meaning of the "underwriter" definition in Section 2(11).
>
> 1 Loss, *Securities Regulation* 642 (2d ed. 1961) (emphasis added).

Loss further notes that "[t]he same rationale would seem to attach equally to the situation where the ordinary pri-

vate investor purchases a security from either an *issuer proper* or an affiliate without benefit of a warrant or conversion privilege." 1 Loss at 643 (emphasis added).

The distinction urged by Loss between an "ordinary investor" and an "underwriter" may not be based simply upon presence or absence of an intent to resell. Investors may be speculators who always have resale intentions. "The speculators and chartists of Wall and Bay Streets are also 'reasonable' investors entitled to the same legal protection afforded conservative traders." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). The relevant intent is intent to effect a "distribution," a term not defined in the 1933 Act. The House Committee strongly intimated that distribution is the biting point of the registration requirements when it reaches "significant proportions" and the distributor is "in the position of controlling the issuer and thus able to furnish the information demanded by the bill." *H.R. Rep. No. 85*, 73d Cong., 1st Sess. 14 (1933).

Subsequent to the decision below, the Commission promulgated Rule 144, 17 C.F.R. § 230.144. In Release No. 5223 under the 1933 Act, the Commission stated that previous administrative practices of its staff had focused on the words "with a view to," in the phrase "purchased from an issuer with a view to . . . distribution" (in the Section 2(11) definition), with resulting emphasis on the subjective mental state of the purchaser and related factors. According to the Commission, experience has shown that reliance upon such factors "has not assured adequate protection of investors . . . and has led to uncertainty in the application of the registration provisions of the Act." The Commission further stated that its Rule 144 (effective April 15, 1972) was designed to replace subjective standards with more objective ones and that the Commission "is of the view that 'distribution' is the significant concept in interpreting the statutory term 'underwriter.'"

Rule 144 is the Commission's first attempt, in almost forty years of administering the 1933 Act, to define by rule conditions under which non-controlling holders of securities acquired from an issuer will not be deemed to be "underwriters." *See* 37 *Fed. Reg.* 591 (No. 9, Jan. 14, 1972). At the time of the transactions by White, the only effective comparable rule was Rule 154, 17 C.F.R. § 230.154, which related only to brokerage transactions by *controlling* persons. See discussion *infra* at 17-18.

Petitioners contend that the distinction between underwriters and other purchasers from an issuer must be made "in light of the statutory purpose," as set forth in *Ralston Purina,* and consistently with the statements of the House Committee. Under the *Ralston Purina* standards, White's lack of knowledge and information material to his purchase of Mountain's stock is critically significant. White accordingly must be treated as a member of the investing "public" for whom the protections of the 1933 Act were designed even though a securities professional, equipped by experience and knowledge to bargain for registration, who purchases a substantial block of securities from an issuer may be an "underwriter." *Compare Gilligan, Will & Co. v. SEC,* 267 F.2d 461 (2d Cir. 1959), *cert. denied,* 361 U.S. 896 (1959) *with Katz v. Amos Treat & Co.,* 411 F.2d 1046 (2d Cir. 1969). White's resales of Mountain shares in an amount not of "significant proportions" should be exempt from registration as transactions by a person other than an issuer, underwriter or dealer under Section 4(1) of the 1933 Act, 15 U.S.C. § 77d(1). To hold otherwise, as the Court of Appeals did, militates strongly against protection of the class of uninformed persons upon whom fraud may be most easily perpetrated and frustrates the evident congressional intent that the burdens of the 1933 Act should fall on those able to discharge those burdens.

E. The interpretation of "distribution" implicit in the holding of the Court of Appeals unfairly subjects non-controlling individuals like White to registration burdens more rigid and restrictive than are imposed upon persons controlling the issuer.

The holding of the Court of Appeals not only unrealistically subjects individuals like White and their brokers to the registration burdens of the 1933 Act but also makes such burdens more rigid and restrictive than are imposed upon controlling persons who have the power to compel the issuer to file a registration statement. In Rule 154 under the 1933 Act, 17 C.F.R. § 230.154, promulgated in 1951, the Commission prescribed conditions under which the term "distribution" does not apply to certain brokerage transactions for the account of controlling persons. Rule 154 states in substance that no "distribution" will be deemed to be involved, under the conditions specified therein, if the relevant sales do not exceed 1 percent of the securities outstanding at the time of the sell order or (if the security is listed upon a national securities exchange) the largest aggregate reported exchange trading volume during one week within the four calendar weeks preceding such order. In effect Rule 154, in accordance with its terms, allows shares owned by a controlling person to be resold through brokers without compliance with the registration requirements even though the controlling person has the power to compel registration.

On the other hand, the holding of the Court of Appeals does not permit non-controlling individuals like White, who owned less than 1 percent of the Mountain shares outstanding, to resell through a broker without registration an insignificant amount of securities which the issuer fraudulently induces them to purchase. The holding consequently imposes unfairly upon individuals like White and their brokers an impossible burden of registration and a stringent concept of "distribution" greater

than is imposed in brokerage transactions for the account of controlling persons pursuant to Rule 154.[4]

II

CERTIORARI SHOULD BE GRANTED BECAUSE, IN DECIDING THAT THE EXEMPTIONS FOR TRANSACTIONS BY A DEALER AND FOR BROKERS' TRANSACTIONS WERE INAPPLICABLE, THE COURT OF APPEALS ERRONEOUSLY DECIDED IMPORTANT QUESTIONS OF FEDERAL LAW WHICH HAVE NOT BEEN BUT SHOULD BE SETTLED BY THIS COURT.

The Court of Appeals rejected claims by Petitioners of availability, in respect to their activities, of the exemptions for "transactions by a dealer" and for "brokers' transactions" contained respectively in Sections 4(3) and 4(4) of the 1933 Act, 15 U.S.C. §§ 77d(3)-(4). In so doing, the Court of Appeals simply stated, without citing supporting authority, that the exemptions are "inapplicable" to transactions involving an "underwriter (White)." (Appendix A at 4a.)

Section 2(12) of the 1933 Act, 15 U.S.C. § 77b(12), defines the term "dealer" to mean "any person who engages . . . as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." The term "broker" is not defined in the 1933 Act. According to the *House Report* issued in 1933, the sole object of including brokers in the definition of "dealer" was "to subject brokers to the same advertising restrictions that are imposed upon dealers, so as to prevent the broker from being used as a cloak for the sale of securities." *H.R. Rep. No. 85,* 73d Cong., 1st Sess. 14 (1933). The *House Report*

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[4] See the discussion of the Commission's Rule 144, 17 C.F.R. § 230.144 at 15-16, *supra*. Among other things, Rule 144 rescinds Rule 154, effective April 15, 1972.

simultaneously made very clear, however, that "[t]ransactions by a broker . . . , provided that they are true brokerage transactions, are not brought within the scope of the bill . . . . " *H.R. Rep. No. 85* at 14. The limited application of the 1933 Act to brokers is further emphasized by the Section 2(11) exclusion, from coverage of the term "underwriter," of "a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual or customary distributors' or sellers' commission."

The stipulated record below shows, without contradiction, that the activities of Quinn & Co. and Dornacker in the resale of White's Mountain stock were limited to acting as his agent or broker on an unsolicited basis in executing White's sell order in the normal course for a customary commission. Irrespective of whether White was a statutory "underwriter" as stated by the Court of Appeals, neither Quinn & Co. nor Dornacker was such "underwriter" because of the statutory exclusion from that term. The Court of Appeals' opinion gives no consideration to the possible effect of the exclusion upon the applicability of exemptions to Quinn & Co. and Dornacker.

A. The exemption for transactions by a dealer

The dealer's exemption in Section 4(3) of the 1933 Act, 15 U.S.C. § 77d(3), exempts from the registration requirements "transactions by a dealer" with certain exceptions.

The Court of Appeals relied upon the second exception contained in subparagraph (C) of Section 4(3) in deciding that the dealers' exemption was "inapplicable." (Appendix A at 4a, including n.9). That exception can apply only on the assumption that White was a statutory "underwriter" and that Quinn & Co. and Dornacker each was a "participant" in the distribution of Mountain's

stock. Petitioners have argued (*supra* at 8-17) the error of the Court of Appeals in holding that White was such an "underwriter." To characterize Quinn & Co. or Dornacker as a "participant" in the distribution of Mountain's stock not only ignores the prior distribution of the stock to White but also conflicts with the exclusion of persons like Quinn & Co. and Dornacker from the statutory definition of "underwriter."

The same *Ralston Purina* considerations previously advanced against the holding that White was a statutory "underwriter" also require that White be viewed as a member of the "public" for purposes of the first exception to the dealer's exemption contained in subparagraph (A) of Section 4(3). On that basis, the shares which he resold commencing in May 1968 were first bona fide offered and sold to the "public," *i.e.*, White, in the summer of 1967 and were resold long after the expiration of 40 days thereafter. Quinn & Co. and Dornacker accordingly were not deprived of the dealer's exemption by the 40-day exception.

B. The exemption for brokers' transactions

Section 4(4) of the 1933 Act, 15 U.S.C. § 77d(4), exempts from the registration requirements "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." In 1933, the *House Report* described the nature and purpose of the exemption (then included in Section 4(2)) as follows:

> Paragraph (2) exempts the ordinary brokerage transaction. Individuals may thus dispose of their securities according to the method which is now customary without any restrictions imposed either upon the individual or the broker. This exemption also assures an open market for securities at all times, even though a stop order against further distribution of

such securities may have been entered. Purchasers, provided they are not dealers, may thus in the event that a stop order has been entered, cut their losses immediately, if there are losses, by disposing of the securities. On the other hand, the entry of a stop order prevents any further distribution of the security.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933).

The quoted legislative history demonstrates clearly the intention of Congress that the 1933 Act should not restrict an individual or his broker in disposing of securities in ordinary brokerage transactions in any available market either before or after the Commission had acted to prevent any further distribution. According to the stipulated record, the first action by the Commission in respect to the stock of Mountain was the suspension of trading therein on August 28, 1968, because of lack of adequate and accurate information disseminated by Mountain and the need for clarification of financial information made public by Mountain. The brokers' exemption was clearly available to Quinn & Co. and Dornacker if, as previously argued, their customer, White, was not an "underwriter."

Contrary to the holding of the Court of Appeals, the same result follows even if White was a statutory "underwriter." The 1933 Act was not intended to subject to its registration requirements the ordinary and customary activities of a broker, which in and of themselves are only incidental to a transaction by the broker's customer-principal and involve no solicitation or advertising directed to public purchasers of securities. Each customer must, however, have his own exemption and may not rely on the broker's exemption to also exempt the customer's transaction. The legislative history quoted *supra* indicates that, if the customer is a dealer, the dealer may not rely on the broker's exemption. Neither may an issuer nor an underwriter escape registration by relying on Section

4(4). Consistently with the legislative history and the inclusion of brokers in the definition of the term "dealer," a dealer *acting as broker* for an individual customer may rely, in respect to his brokerage activities only, on the exemption for brokers' transactions even if no dealer's exemption is available.

But recognition that an issuer, underwriter or dealer may not rely on the brokers' exemption for their own transactions does not preclude its availability to a broker, acting simply *qua* broker, irrespective of availability of an exemption to his customer. The term "customer" used in Section 4(4), like the term "broker," is not defined in the 1933 Act. The "transactions" normally effected by a broker, acting simply as broker without solicitation of orders, are very limited and, in and of themselves, do not involve advertising, dissemination of selling literature or conduct *by the broker* which the 1933 Act attempts to regulate. Such limited brokerage functions are indispensable to assuring the public benefit of "an open market for securities at all times . . . . " as envisaged by the House Committee which considered the legislation. *H.R. Rep. No. 85,* 73d Cong., 1st Sess. 16 (1933).

General availability of the Section 4(4) exemption for brokers' activities for any customer other than an issuer is entirely consistent with previous administration of the 1933 Act and court decisions. If the customer is an issuer, the broker *himself* would be an "underwriter" offering or selling "for an issuer" under the Section 2(11) definition. Controlling persons are deemed to be "issuers" for purposes of the Section 2(11) definition of the term "underwriter." Nevertheless, the Section 4(4) exemption is not lost to the broker simply because his customer is a controlling person, as Rule 154 makes clear, even though controlling persons, together with issuers, underwriters and dealers, are primarily subject to the impact of the 1933 Act's registration burdens. Similarly the exemption should not be lost to the broker simply because his customer is an underwriter, particularly in view of the Section 2(11) exclusion from coverage of the term "under-

writer." Availability of the exemption to the broker for normal broker's functions will not prevent bringing his controlling-person principal to account if the principal is violating the registration requirements (*see, e.g., United States v. Wolfson,* 405 F.2d 888 (2d Cir. 1968), *cert. denied,* 394 U.S. 946 (1969)) or bringing to account the purported broker who in fact is himself an underwriter for a controlling person (*see, e.g., In re Ira Haupt & Co.,* 23 S.E.C. 589 (1946)) or is an underwriter offering for an issuer (*see, e.g., SEC v. Chinese Consolidated Benevolent Association, Inc.,* 120 F.2d 738 (2d Cir. 1941), *cert. denied,* 314 U.S. 618 (1941)).

That Congress considered the brokerage exemption to be generally available is further evidenced by the statement of the Senate Committee in 1954, after the *Ira Haupt* case and before adoption of Rule 154, that no amendment of the exemption for brokers' transactions was necessary because the Commission had assured the Committee that it was considering a rule to "give relief from the popular interpretation" of the Commission's opinion in the *Ira Haupt* case. *S. Rep. No. 1036,* 83d Cong., 2d Sess. 7 (1954).

Furthermore, the inclusion of agents and brokers in the Section 2(12) definition of the term "dealer" may not be read so as to make the terms "broker" and "dealer" synonymous for all 1933 Act purposes. Doing so would make superfluous the separate exemption for brokers' transactions in Section 4(4) (except possibly to permit a dealer, acting as broker, to execute a customer's order during effectiveness of a stop order by the Commission), since Section 4(3) would cover the subject of brokers' exemptions. Section 4(4) in such event would only confuse that subject.

The 1933 Act was meticulously drafted in Sections 2(11), 2(12), 4(1), 4(3) and 4(4) to exempt all ordinary brokerage activities involving no solicitation from the registration requirements of Section 5. At the same time,

the draftsmen were extremely careful to assure non-availability of the Section 4(4) exemption if the broker (as distinguished from his customer) is an underwriter or an issuer or a dealer (in any sense other than a broker), or if the broker engages in any advertising or soliciting. The holding below of the Court of Appeals glosses over the careful statutory distinctions and frustrates the clear intention of the Congress that purely brokerage functions, such as are here concerned, should not be subjected to the 1933 Act's registration burdens.

III

CERTIORARI SHOULD BE GRANTED BECAUSE THE QUESTIONS ERRONEOUSLY DECIDED BY THE COURT OF APPEALS ARE OF SUBSTANTIAL IMPORTANCE TO INVESTORS, ISSUERS, THE SECURITIES INDUSTRY AND THE PROPER ADMINISTRATION OF THE 1933 ACT.

Questions under the 1933 Act is respect to resale of securities purchased directly from an issuer by non-controlling individuals like White are of pervasive importance to issuers, their vendees and the administration of the 1933 Act. Such questions necessarily arise in every offering to public purchasers by an issuer directly, even if made pursuant to a 1933 Act registration statement, and to further resale of the securities so offered. The holding of the Court of Appeals hinges legal consequences of considerable national significance upon subjective factors incident to the private purchaser's state of mind in regard to public resale of an insubstantial amount of his securities without regard to how, as a practical matter, legal compliance can be achieved or to the fundamental fairness of the resulting legal consequences to individuals like White. Subsequent to the transactions and holding here concerned, the Commission has indicated, in adopting Rule 144, that reliance upon such subjective factors may be misplaced. Even Rule 144 does not, however, effectively protect individuals like White.

Apart from the uncertainty damaging to a healthy administration of the 1933 Act and to honest business resulting from such subjectivism, the holding below can be expected to encourage the very conduct by fraudulent issuers and their controlling persons which the 1933 Act interdicts. Victims like White may be discouraged from reporting or otherwise taking action on account of violations, when discovered, in fear of being themselves charged with complicity as a statutory "underwriter" in whatever illegality may be present. The holding can be expected to deter honest individual purchasers and their brokers from resale of securities even if, in the final subjective analysis by the Commission or a court, they were legally entitled from the outset to resell.

In the 1933 Act, Congress aimed at assuring a free and open securities market at all times. The holdings of the Court of Appeals that White was an "underwriter" and that the Section 4(4) exemption for brokers' transactions was "inapplicable" lack fidelity to that congressional aim. All day-to-day securities trading must proceed in reliance by sellers upon availability of the exemption for "transactions by any person other than an issuer, underwriter or dealer" contained in Section 4(1) of the 1933 Act, 15 U.S.C. § 77d(1). Such trading proceeds in massive volume upon exchanges and in the over-the-counter market, usually through brokers relying upon the Section 4(4) exemptions. If brokers acting without solicitation for a small commission for individuals like White have, as stated by the Court of Appeals, a "duty to investigate" and are "expected to secure compliance with the requirements of the Act to protect the public from illegal offerings" (Appendix A at 5a), the only alternative open to a prudent broker is to decline all orders from any individual possibly within the ambit of the sweeping language of the Section 2(11) definition. As a practical matter, a broker cannot otherwise assure himself that his own activities will be lawful except possibly after unreasonable delay.

expense and difficulty. To that extent, the congressional aim is stultified; and small individual investors may be deprived access to the securities market on the theory, incomprehensible to the unsophisticated, that they may be statutory "underwriters." Congress intended otherwise in enacting the Section 4(1) and 4(4) exemptions. It attempted to place the registration burdens of the 1933 Act upon issuers, underwriters and dealers as distinguished from non-controlling individuals and their brokers acting without solicitation.

Conclusion

The stipulated record below discloses a fraudulent scheme perpetrated upon White in violation of Sections 5 and 17 of the 1933 Act. Lacking background and experience in securities matters as well as the material information necessary to any informed decision, White in the summer of 1967, in reliance upon Mountain's material misstatements and oblivious to its material omissions, assumed the substantial finacial risks inherent in his commitment to purchase Mountain's stock and his loss of control over property of substantial value. White was always powerless to cause Mountain to effect any 1933 Act registration and had no material relation to Mountain except as the holder of an insubstantial amount of Mountain's stock. Acting upon White's unsolicited order almost a year after his first victimization by Mountain, Quinn & Co. as White's agent effected unsolicited brokers' transactions for part of White's stock, receiving only a customary commission.

On essentially the foregoing facts, the Court of Appeals erroneously held that White was a statutory "underwriter" and that no 1933 Act exemption from registration was available to Quinn & Co. and Dornacker. For all reasons set forth herein, the Court of Appeals erroneously decided important questions of federal law con-

trary to the principles enunciated by this Court in *SEC v. Ralston Purina Co.* The Court of Appeals also erroneously decided important questions which have not been but should be settled by this Court.

Certiorari should be granted.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE TENTH CIRCUIT

No. 71-1090—November Term, 1971

(Argued October 27, 1971 Decided December 17, 1971)

QUINN AND COMPANY, INC., and JOHN DORNACKER,
Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

BEFORE: PICKETT, HILL and BARRETT,
United States Circuit Judges.

HILL, *Circuit Judge.*

Quinn and Company, Inc. and Dornacker have petitioned this Court to review an order of the Securities and Exchange Commission entered on January 25, 1971, suspending Dornacker from association with any broker or dealer for a period of 20 days, and suspending Quinn and Company, Inc., from membership in the National Association of Securities Dealers, Inc., for a 15-day period to begin concurrently with Dornacker's suspension. By an order entered January 29, 1971, the Commission granted petitioners' request for a stay of its suspension order

pending review by this Court. Our review is based on 15 U.S.C. § 78y(a).[1]

The Commission found that Quinn and Company, and Dornacker, as vice president of Quinn, has willfully violated the registration provisions of the Securities Act in the offer, sale and delivery of the common stock of Mountain States Development Company, for which no securities registration statement had been filed or was in effect. The Mountain stock was sold by Quinn for the account of White, who had been a customer since 1963. The stock had been acquired by White directly from the issuer, Mountain, as a result of an agreement with Graham, the president of Mountain. It was established at the hearing before the Commission that Graham, wishing to buy certain logging equipment and gas well interests held by White, had approached the latter. White wanted cash, but was persuaded to take Mountain stock, which he was assured could be resold for cash.

The central issue in this case is whether White was a statutory "underwriter" with respect to the 25,000 shares of unregistered Mountain stock that Dornacker sold through Quinn and Company, Inc. Petitioners argue that the Commission erroneously found White to be an underwriter, pursuant to 15 U.S.C. § 77b(11).[2] Instead, petitioners argue

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[1] 15 U.S.C. § 78y(a) Any person aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person is a party may obtain a review of such order in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business . . . .

[2] 15 U.S.C. § 77b(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such terms shall not include a person whose interest is limited to a commission from an underwriter or dealer in excess of the usual and customary distributors' or sellers' commission.

that the Mountain-White transaction should be exempt under 15 U.S.C. § 77d(1).[3]

Since petitioners are claiming the availability of the exemption from registration, the burden of proof is clearly upon them to prove that White was not an underwriter.[4] The exemption relied upon must be strictly construed against the person claiming its benefit,[5] as public policy strongly supports registration.[6] We are compelled to affirm the holding of the Commission that White was an underwriter. The term underwriter is not limited to its common definition, but rather is a word of art. An underwriter is one who purchases stock from the issuer with an intent to resell to the public.[7] Petitioners urge that this Court should find White to be other than an underwriter on the basis of its prior decision in Can-Am Petroleum Co. v. Beck, 331 F.2d 371 (10th Cir. 1964). In that case, a defrauded investor who had actively participated in the promotion and sale of the issuer's stock was not an underwriter. We find Can-Am distinguishable. Mrs. Beck, the defrauded investor, sold none of the stock she herself had acquired to the public. She had acquired that stock for investment purposes; she promoted sale of other stock to the public. White, on the other hand, acquired the Mountain stock with a view to resale. Thus the facts in the instant case and those in Can-Am are dissimilar.

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[3] 15 U.S.C. § 77d Exempted Transactions. The provisions of 77e [stock registration] of this title shall not apply to (1) transactions by any person other than an issuer, underwriter, or dealer.

[4] Sec. and Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 126 (1953); Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963); Woodward v. Wright, 266 F.2d 108, 115 (10th Cir. 1959).

[5] United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir. 1967), *cert. denied* 389 U.S. 850.

[6] Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963).

[7] Gilligan, Will & Co. v. Sec. and Exch. Comm'n, 267 F.2d 461 (2d Cir. 1959), *cert. denied* 361 U.S. 896.

Petitioners additionally contend that White's sale was quantitatively insufficient to constitute a public distribution. The purpose of the Securities Act is the protection of the investing public, whether the stock is acquired directly from the issuer or through an intermediary. It is firmly established that an issuer cannot avoid registration of its securities for a public offering simply by limiting the number of shares sold.[8] This Court is cognizant of the fact that the amount of Mountain shares sold by White does not form a great percentage of the total issue. However, under the circumstances, resale by White of 25,000 shares of Mountain stock constituted a public distribution.

The dealers' and brokers' exemptions contained in 15 U.S.C. § 77d[9] are inapplicable here. These exemptions are inapplicable to transactions involving an underwriter. Since the transactions effected by Quinn and Company, Inc. for White in the present case involved an underwriter (White), the exemptions are not available.

We agree with the Commission's finding that Quinn and Company, Inc. and Dornacker willfully violated the registration provisions of the Securities Act. White was an underwriter; Quinn and Company, Inc. and Dornacker sold the Mountain stock in violation of the Securities Act. Petitioners, as professionals in the securities business and as persons dealing closely with the investing public,

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[8] Sec. and Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119 (1953).

[9] 15 U.S.C. § 77d Exempted Transactions. The provisions of section 77e [stock registration] of this title shall not apply to— . . . (3) transactions by a dealer . . . , except . . . (c) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter . . . (4) brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders.

are expected to secure compliance with the requirements of the Act to protect the public from illegal offerings.[10] Quinn and Company, Inc. and Dornacker were not entitled to rely on the lack of cautionary legends on the stock certificates. Brokers and securities salesmen are under a duty to investigate, and a violation of that duty brings them within the term "willful" of the Securities Exchange Act.[11] The commission was thus justified in finding petitioners' conduct willful within the meaning of the Act.

It is firmly established in this Circuit that the Commission, not the courts, has the primary responsibility for protection of investors in securities.[12] The Commission has broad discretion in applying sanctions for violation of the Securities Act.[13] Absent a clear abuse of that discretion, the Court will not substitute its views as to what the punishment shall be.[14] We find no abuse of discretion here. Accordingly, the Commission's order is affirmed.

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[10] Stead v. Sec. and Exch. Comm'n, 444 F.2d 713, 716 (10th Cir. 1971).

[11] Hanly v. Sec. and Exch. Comm'n, 415 F.2d 589, 595-6 (2nd Cir. 1969).

[12] Stead v. Sec. and Exch. Comm'n, *supra*.

[13] Anderson and Co. v. Sec. and Exch. Comm'n, 423 F.2d 813, 817 (10th Cir. 1970).

[14] *Id.*

APPENDIX B

UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

January 25, 1971

IN THE MATTER OF

QUINN AND COMPANY, INC.
(8-14364)

JOHN DORNACKER

FINDINGS AND OPINION OF THE COMMISSON

BROKER-DEALER PROCEEDINGS
Sales of Unregistered Securities
Definition of Underwriter
Brokers' and Dealers' Exemptions

Where officer or registered broker-dealer, while partner of predecessor broker-dealer, willfully violated registration provisions of the Securities Act of 1933, *held* under circumstances in public interest to impose suspensions on officer and registrant.

Person who obtains stock directly from issuer with intent immediately to sell such stock on open market, is statutory underwriter under Securities Act, and no exemption under Section 4 of that Act is available for such sales by him and broker-dealer through whom they are made.

Appendix B

Person who obtains stock from issuer with intent to resell to public is statutory underwriter regardless of whether or not he was deceived by issuer respecting saleability of stock without registration.

Exemptions under Section 4 of the Securities Act for brokers and dealers are primarily intended to except normal trading transactions from registration requirements, and such exemptions are not available where broker-dealer is aware of circumstances indicating that seller is underwriter engaged in distribution.

Broker-dealer is not relieved of responsibility to take steps to avoid violations of registration requirements of Securities Act because of issuer's dereliction or failure to take precautions by way of restrictive legend on certificates of unregistered shares.

These proceedings pursuant to Sections 15(b), 15A and 19(a) (3) of the Securities Exchange Act of 1934 concern Quinn and Company, Inc. ("Quinn Inc.") which has been a registered broker-dealer since March 15, 1969 and is the successor to Quinn and Co. ("Quinn Co."), a partnership which was registered as a broker-dealer on March 14, 1946, and John Dornacker, who was a general partner in Quinn Co. and is a vice-president of Quinn Inc.[1] The order for proceedings alleges that during the period from May through August 1968, Quinn Co. and Dornacker willfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 in that they offered to sell, sold and delivered after sale shares of the common stock of Mountain States Development Company ("Mountain") when no registration statement had been filed or was

[1] Quinn Inc. is and Quinn Co. was a member of registered national securities exchanges and of the National Association of Securities Dealers, Inc.

in effect as to said securities pursuant to the Securities Act.

Respondents entered into a stipulation with our Division of Trading and Markets in which, for the purposes of these proceedings or any other proceeding pursuant to Section 15(b) of the Exchange Act or Section 203(d) of the Investment Advisers Act of 1940, they stipulated to certain facts. A hearing and a hearing examiner's initial decision were waived, and proposed findings and supporting and reply briefs were filed by respondents and the Division. Our findings are based upon an independent review of the stipulated record.[2]

Sales of Mountain Securities

In April 1968, one Ted M. White, a prior customer of Quinn Co.,[3] told Dornacker that he was in the process of obtaining Mountain stock in exchange for certain properties he owned, and that he wanted to sell the stock when he received it. Shortly thereafter White delivered to Quinn Co., to sell for him, six certificates totaling 37,000 shares of Mountain stock in his name, which Mountain had issued on May 1, 1968. In the period May through August 1968, Dornacker executed through Quinn Co. orders to sell 25,000 shares of White's Mountain stock. Of the 25,000 shares, 21,000 shares were sold on the Salt Lake Stock Exchange through a member firm which acted as agent for Quinn Co., 1,000 shares each were sold to two other broker-dealers who published quotations on Mountain stock, and the remaining 2,000 shares were sold to a

[2] The stipulation provided that oral argument would be subject to an appropriate further order by us. No request for oral argument has been made and we do not deem it necessary.

[3] Dornacker had opened an account at Quinn Co. for White in January 1963, and two transactions were effected through it in 1963. The account then was inactive until the 1968 transactions in Mountain stock described herein.

retail customer of Quinn Co., who assertedly entered an unsolicited order. Mountain, which acted as its own transfer agent, transferred the first 17,000 of these shares as requested by Quinn Co., but in September 1968 it refused to transfer the remaining 8,000 shares, stating that the certificates represented unregistered investment stock which could not be transferred without compliance with our Rules and Regulations.[4]

During the following month, Dornacker visited our staff and discussed with it the above transactions in Mountain stock, and was advised that it appeared that his firm had participated in an illegal distribution of unregistered stock. He requested White to refund the proceeds paid him by Quinn Co. from the sale of the 8,000 shares on which transfers had been refused or to furnish other certificates which were registered and could be properly transferred. Quinn Co. also contacted the purchasers of those shares in an attempt to cancel those sales and secured cancellation as to 3,000 shares. White then arranged for the delivery to Quinn Co. of other Mountain shares owned by one Newell R. Hays, a large stockholder of Mountain, which Mountain advised Quinn Co. were transferable, and the transactions on the remaining 5,000 shares of Mountain stock were reinstated.

At the time all the above events took place, there was no registration statement under the Securities Act on file or in effect with respect to any Mountain stock.

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[4] On August 28, 1968, we suspended trading in Mountain stock pursuant to Sections 15(c) (5) and 19(a) (4) of the Exchange Act, because of serious questions as to the accuracy of information about the company and its operations. Securities Exchange Act Release No. 8396. The Salt Lake Stock Exchange, on which the stock is listed, had suspended exchange trading on August 22, 1968. In April 1969, Mountain and certain of its officers and associates (Civil Action No. C-68-69, U.S.D.C., D. Utah) were enjoined on consent from violating the registration, anti-fraud and reporting provisions of the securities laws. Litigation Release No. 4313 (May 7, 1969). The suspension of trading of Mountain stock terminated on April 28, 1969. Securities Exchange Act Release No. 8583 (April 24, 1969).

Appendix B

Violations of Section 5 of the Securities Act

It is evident that transactions in unregistered Mountain shares described above were in violation of Sections 5(a) and 5(c) of the Securities Act unless an exemption was available as to them.[5] It is well settled that the burden of proving entitlement to an exemption from the general policy of the Securities Act requiring registration rests with the person claiming the exemption.[6] Respondents have not sustained such burden here.

Respondents have urged first that there was available for White's sales the exemption from registration provided by Section 4(1) of the Securities Act for "transactions by any person other than an issuer, underwriter, or dealer." We do not believe that this exemption is available, however. While not an issuer or a dealer, White was an underwriter in the statutory sense. Section 2(11) of the Securities Act defines an underwriter to include "any person who has purchased from an issuer with a view to . . . the distribution of any security." In this case, White acquired his shares directly from the issuer, with the intent, which he carried out, to begin immediately to resell them to the public.

In view of the primary purpose of the Securities Act to protect investors through the registration provisions, the courts have given a broad interpretation to the term "underwriter" and have held that it is not necessary to show that one who participated in and engaged in steps necessary to a flow of securities from an issuer to the

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[5] *See e.g., Gilligan, Will & Co.*, 38 S.E.C. 388, 391 (1958), *aff'd* 267 F.2d 461 (C.A. 2, 1959), *cert. denied*, 361 U.S. 896.

[6] *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119 (1953); *S.E.C. v. Culpepper*, 270 F.2d 241, 246 (C.A. 2, 1959); *Pennaluna & Co. v. S.E.C.*, 410 F.2d 861, 865 (1969).

public had a conventional relationship to or a contractual privity with the issuer in order to find such a person to be a statutory underwriter.[7] Even though offers and sales may not give the appearance of a conventional public distribution, one who acquires securities from an issuer for public resale becomes an underwriter within the meaning of the Securities Act.[8]

The fact that the general purpose of the Securities Act is to protect "investors" does not mean that all transactions by a person who had characteristics of an ordinary investor are exempt from its registration requirements. On a previous occasion we noted that the term "underwriter" is broadly defined in Section 2(11) and emphasized that individual investors who are not professionals in the securities business may be "underwriters" within the meaning of that term as used in the Securities Act if they act as links in a chain of transactions through which securities move from an issuer to the public.[9]

There is not present here any question concerning the intent with which the securities were acquired from the issuer. It is clear that White intended to resell his Mountain shares on the open market as soon as possible so as to obtain cash for the property interests he sold to Mountain and not to become a stockholder of Mountain. His acceptance of the Mountain stock and immediate resale for cash did not differ in essence from an arrangement whereby the issuer sold the stock to the public for cash and used the cash so raised to buy White's properties, an arrangement which clearly would have required registra-

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[7] *Cf. S.E.C.* v. *Chinese Consolidated Benevolent Association*, 120 F.2d 738 (1941), *cert. denied*, 314 U.S. 618; *S.E.C.* v. *Culpepper*, 270 F.2d 241 (C.A. 2, 1959).

[8] *Gilligan, Will & Co.*, 38 S.E.C. 388, 392 (1958), *aff'd* 267 F.2d 461 (C.A. 2, 1959), *cert. denied*, 361 U.S. 896.

[9] Securities Act Release No. 4997, page 15 (September 15, 1969).

tion for the securities so sold to the public. If the view that the same securities could flow from the issuer to the public without registration merely because of the interposition of the seller of property to the issuer under these circumstances were upheld, public distributions of securities could be readily effected without compliance with the registration, prospectus and other protective provisions of the Securities Act, contrary to the basic policy of that Act.

Respondents seek to escape this result by contending that White was an investor who purchased unregistered securities sold to him by the issuer in furtherance of a fraudulent scheme,[10] and that as a "defrauded" investor he was a member of the class of persons that the Securities Act is intended to protect. They urge that under the circumstances White should not be deemed an underwriter notwithstanding any intent to resell his shares in the public market. There is no exemption from the registration provisions of the Act for a person otherwise subject thereto, on the ground that he was defrauded by the

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[10] Respondents assert that the sale of stock by Mountain to White was in violation of the registration and antifraud provisions of the Securities Act, in view of the fact that no registration statement was in effect and because of material misstatements and omissions, including misrepresenations to White by Mountain's president that "SEC approval" had been or would be obtained for delivery of the stock to White and the failure to make any statements about any restrictions upon resale by White of the stock delivered to him, to disclose that no registration statement had been filed or was in effect or to place any restrictive legend on the certificates, even though Mountain's president was aware that White planned to resell the stock through a broker.

It appears that White agreed on a price of approximately $17,500 for his properties, that he had received $1,500 in cash, and that his principal concern was to recover approximately $16,000 from the sale of the stock he received from Mountain. He actually received net proceeds of $23,671 from the sale of that stock by Quinn Co. The Division contends that the facts in the stipulated record compel the conclusion that White was not defrauded by Mountain but rather was a party to an illegal distribution of unregistered securities. Neither White nor Mountain is a respondent in the instant proceedings, and we do not undertake here to determine whether or not a fraud was practiced on White by Mountain.

issuer. A person's status as an underwriter under the statutory definition is not changed thereby.

Respondents are not aided by the decision in *Can-Am Petroleum Co.* v. *Beck* cited by them.[11] In that case, the Court held that an investor could maintain an action under Section 12 of the Securities Act to rescind a purchase of securities induced by material misrepresentations by the issuer, despite the claim that she was in *pari delicto* with the issuer and was an underwriter because after making her initial investment she induced purchases by others and assisted in the issuer's promotional efforts for which she received additional securities as compensation. The Court stated that an investor does not waive or lose the shelter of the Securities Act because he becomes to some extent involved in the illegality of the securities sales. Noting that Beck was sought out as a potential investor and was "sold" on her investment through the issuer's misrepresentations, the Court concluded that, for purposes of the issuer's liability to her, her "isolated endeavor to join with Can-Am in disposing of their entire interests did not change her relationship from that of investor to underwriter."[12] The Court's statements in no way stand for the proposition that an investor who becomes a statutory underwriter has a right to resell the securities to the public without registration. Unlike the situation in the instant case, there was no indication that the purchaser acquired her securities from the issuer with the intent to resell them to the public, and she did not resell them. Whatever White's rights might have been or might be as against Mountain and its president, by acquiring his shares directly from the issuer with the intent of immediately selling them on the open market

[11] 331 F.2d 371 (C.A. 10, 1964).

[12] Id. at 373-374.

(and doing so) White became a statutory underwriter, and accordingly the exemption under Section 4(1) was not available for his transactions.

Respondents next argue that even if White is deemed to have been a statutory underwriter, Quinn Co. had no interest in the sale of White's shares except for its usual commissions and charges computed in accordance with the New York Stock Exchange Commission schedules[13] and was at most a dealer[14] and entitled to the dealers' exemption under Section 4(3) or the brokers' exemption under Section 4(4) of the Securities Act. We cannot agree.

We start with the basic premise that the provisions of Sections 4(1), 4(3) and 4(4) are intended to exempt trading transactions with respect to securities already issued to the public and that they cannot be used to exempt distributions by issuers or underwriters or the acts of other persons who engage in steps necessary to such distributions.[15] Thus, whether or not Quinn Co. is characterized as an underwriter itself,[16] it participated in public sales of unregistered securities by an underwriter, White, and the process of distribution itself, however carried out, is subject to the registration requirements of Section 5.[17]

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[13] Section 2(11) excludes from the definition of underwriter any person "whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission."

[14] Section 2(12) defines the term "dealer" to include both a person who engages in the securities business as principal (dealer) and one who does so as agent (broker).

[15] See *e.g.*, *Sutro Bros & Co.*, 41 S.E.C. 470, 477-478 (1963).

[16] The Division cites the provision in Rule 141(c) under the Securities Act excluding from the term "usual and customary distributors' or sellers' commission" as used in Section 2(11), "amounts paid to any person whose function is the management of the distribution of all or a substantial part of the particular issue." It contends that Quinn Co. managed the distribution of White's shares within the meaning of this Rule and is therefore not excluded from the Section 2(11) definition of underwriter. See *Sutro Bros. & Co.*, *supra*, p. 477.

[17] *Ira Haupt & Co.*, 23 S.E.C. 589, 604 (1946).

Appendix B

Clearly the exemption in Section 4(1) was not available to Quinn Co., for it was in any event a dealer as defined in the Act. Accordingly, it must find its exemption, if any, under the provisions of Section 4(3) or Section 4(4) providing exemptions for dealers and brokers. For the reasons set forth below, no exemption under either of these Sections was available to Quinn Co. under the circumstances of this case.

The legislative history of the brokers' exemption indicates that it was meant to preserve the distinction between distribution, with which the Securities Act is mainly concerned, and trading. The exemption in Section 4(1) for transactions by persons other than an issuer, underwriter or dealer evidences Congress' intent that such other persons should be free to trade in securities, and, to allow them to do so through the use of brokers, a special exemption was provided in what is now Section 4(4) for dealers acting as brokers.[18] Consistent with the purpose of the Section 4(4) exemption to permit a dealer to act as a broker for an individual's trading transactions, the House Committee Report on the legislation indicates that the brokers' exemption is not available when the selling principal is a dealer.[19] *A fortiori*, the brokers' exemption cannot be available when the broker knows or has reasonable ground to believe that the selling customer's part of the transaction is not exempt since in that event the

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[18] Section 4(4) exempts brokers' transactions executed upon customers' orders but not the solicitation thereof. When the Act was adopted, the brokers' exemption appeared as Section 4(2).

[19] H. R. Rep. No. 85, 73d Cong., 1st Sess., pp. 15-16 (1933).

broker likewise violates Section 5 by participating in a non-exempt transaction.[20]

We have previously recognized the obligation of a broker-dealer asked to sell a block of unregistered securities to take whatever steps are necessary to be sure that he is not participating in transactions involving an underwriter and that a broker cannot rely on the Section 4(4) brokers' exemption when he is aware of circumstances indicating that his principal is an underwriter.[21] Here Dornacker knew of the two most critical factors indicating that White was an underwriter and that his sales did not constitute normal trading activity: one, that White had obtained shares directly from the issuer; and two, that White sought to sell such shares to the public as soon as possible after receiving them.

By the same token, the dealers' exemption in Section 4(3) is not available to a dealer who is selling unregistered securities for an underwriter. The House Report, again emphasizing the distinction between trading and distribution, stated that in recognition of the fact that a dealer is often concerned not only with the distribution of securities but also with trading in securities, an exemption was provided for a dealer as to trading when such trading

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[20] Loss, *Securities Regulation*, Vol. 1, p. 698 (2nd Ed. 1961).

[21] See *e.g.*, Securities Act Release No. 4445, p. 2 (February 2, 1962); Securities Act Release No. 4818, pp. 1-2 (January 21, 1966); Securities Act Release No. 4997, p. 11 (September 5, 1969); Securities Act Release No. 5087, p. 3 (September 22, 1970). *Cf.* also Rule 154(a) (4) under the Securities Act, under which the term "brokers' transaction" in Section 4(4) is not deemed to include transactions by a broker acting as agent for a person in a control association with an issuer in any situation where the broker is aware of circumstances indicating that his principal is an underwriter. See *e.g.*, *Skiatron Electronics and Television Corp.*, 40 S.E.C. 236, 250-251 (1960).

occurs after a period of distribution.[22] It is apparent from that statement that transactions by a dealer during the period of distribution are not exempted from the registration and prospectus requirements,[23] and this conclusion is particularly compelling when the dealer is acting directly for a statutory underwriter.

Moreover, by its specific terms the Section 4(3) dealers' exemption is not available during the 40 days after the first date upon which the security was offered to the public by an underwriter; nor is such exemption available for transactions as to securities constituting the whole or a part of an unsold allotment to the dealer as a participant in the public sale of such securities by an underwriter.[24] Since Quinn Co. through Dornacker undertook to sell all or part of White's block of Mountain stock for him almost immediately after he obtained the stock certificates from the issuer, it is apparent that it was not entitled to the exemption under Section 4(3) for trading transactions by dealers.[25]

There being no registration statement in effect for Mountain's securities and no exemption available at the time Quinn Co. and Dornacker effected sales and deliveries after sale of Mountain stock for White's account, we find that they violated Section 5 of the Securities Act. We also find that their violations were willful within the meaning of Section 15(b) of the Exchange Act. It is well settled

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[22] H. R. Rep. No. 85, 73d Cong., 1st Sess., p. 16 (1933).

[23] *Ira Haupt & Company*, 23 S.E.C. 589, 603 (1946).

[24] Section 4(3) (A) and (C).

[25] The dealer's exemption does not extend to the transactions which themselves are the public offering of the securities. *Sutro Bros. & Co.*, 41 S.E.C. 470, 477 (1963); Loss, *Securities Regulation*, Vol. 1, p. 258 (2nd Ed. 1961).

that a finding of willfulness under the Exchange Act does not require that we find an intent to violate, but merely an intent to do the act which constitutes a violation.[26] Quinn Co. and Dornacker obviously intended to offer and sell White's securities and it is admitted that at the time of the transactions they were aware that no registration statement as to them was in effect. Moreover, as noted, they also knew that White had obtained his stock directly from the issuer immediately prior to the transactions and that White never intended to keep the stock for investment purposes.

Broker-dealers have a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act and should be reasonably certain such an exemption is available.[27] The immediate resale by White of a block of stock he obtained directly from the issuer should have caused Dornacker to question the availability of any exemption from the registration provisions of the Securities Act.[28] While Dornacker apparently realized there was a question as to the availability of an exemption based on the facts known to him, he did not seek legal counsel or consult our staff prior to the transactions,[29] but satisfied himself with merely telling White to obtain certificates in acceptable

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[26] *Gilligan, Will & Co.*, 38 S.E.C., 388, 395 (1958), *aff'd* 267 F.2d 461, 468 (C.A. 2, 1959); *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965).

[27] See *e.g.*, *Stratlimore Securities, Inc.*, Securities Exchange Act Release No. 8207, p. 8 (December 13, 1967).

[28] *Cf. S.E.C.* v. *Mono-Kearsage Consolidated Mining Company*, 167 F. Supp. 248, 259 (D. Utah, 1958), where the Court stated that a dealer cannot "close his eyes to obvious signals" or "red flags" warning him to go slowly. See also *Dlugash* v. *S.E.C.*, 373 F.2d 107, 109 (C.A. 2, 1967).

[29] *Cf. S.E.C.* v. *Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959).

delivery form.[30] Quinn Co. and Dornacker were not entitled, as respondents contend, to rely on the absence of any restrictive or cautionary legends on the Mountain certificates issued to White or any warning by Mountain as to saleability restrictions. While such a legend or instructions to transfer offices may serve as useful devices by issuers to alert buyers to the restricted character of unregistered securities and to prevent violations of the registration requirements,[31] the failure of an issuer to take such measures cannot relieve a broker-dealer from his duty as a professional in the securities business to make a reasonable inquiry into facts known to him indicating that he is participating in an illegal sale of unregistered securities.

Public Interest

Respondents urge that the public interest does not require the imposition of any sanctions. They argue that the conduct in question consisted merely of executing on an ordinary agency basis an unsolicited order to sell a relatively small block of a stock which was listed on an exchange[32] for a customer who was not affiliated with the issuer or its controlling persons. They point out that Quinn Co. is no longer in existence and its registration has

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[30] Although Dornacker told White he would not pay him the proceeds of the sales until after the acceptance of the stock certificates by Mountain for transfer to the purchasers, after Mountain accepted for transfer certificates for the first 17,000 shares that Quinn Co. sold for White, Quinn Co. paid White for the entire 25,000 shares so sold without waiting for the transfer of the last 8,000 shares, which as noted was subsequently refused by Mountain.

[31] See for example, Securities Exchange Act Release No. 4997, p. 16 (September 5, 1969).

[32] There were 2,982,915 shares of Mountain stock outstanding on December 31, 1967, and 5,469,716 shares outstanding in March 1969.

been withdrawn, and they stress that Quinn Inc. has instituted procedures designed to prevent violations of Section 5 and that Quinn Co. and Dornacker, as well as Quinn Inc., have never before been the subject of any disciplinary proceedings by us.

Insofar as Dornacker is concerned, we consider that a sanction should be imposed in the public interest in view of his failure to carry out his responsibility to examine carefully sales by customers who have obtained stock directly from the issuer to insure that violations do not occur. In determining what sanction would be appropriate, however, we have taken into account the various factors urged by respondents in mitigation and the fact that Quinn Co. made full restitution to its only retail purchaser even though it had paid the net sales proceeds to White. Under all the circumstances we conclude that Dornacker should be suspended from association with any broker or dealer for a period of 20 days.

As to Quinn Inc., as respondents concede, a sanction may be imposed upon it, if in the public interest, under the specific provisions of Section 15(b) (5) of the Act, upon the basis of the willful violations of Dornacker, who is an officer and an associated person of Quinn Inc., even if such violations took place prior to his current association with Quinn Inc. In considering the public interest, we note that Quinn Inc. is the successor to the business, assets and liabilities, and offices and staff of Quinn Co. and that Dornacker, who was a partner in Quinn Co. continued his functions as an officer of Quinn Inc.[33] On the other hand, we give recognition to the various mitigative factors described above. We conclude that it is appropriate

[33] Following the filing by both the Division and respondents of briefs as provided for in the stipulation, the Division sought leave to respond to respondents' statement in their reply brief that Quinn Inc. cannot be

in the public interest to suspend Quinn Inc. from membership in the National Association of Securities Dealers, Inc. for a period of 15 days.

An appropriate order will issue.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG).

Orval L. DuBois
Secretary

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found to have violated the Act on the basis of Quinn Co.'s actions, and various further related motions and counter motions were filed. We have taken into account in our consideration of the public interest the substantial identity between Quinn Inc. and Quinn Co., and we have noted that respondents concede that a sanction may be imposed upon Quinn Inc. under the specific provisions of Section 15(b) (5) of the Act. Under the circumstances we do not consider that the matters raised by the motions, which go beyond the provisions of the stipulation governing the disposition of this matter, are necessary to our conclusions, and all such motions are denied.

Appendix B

UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

January 25, 1971

IN THE MATTER OF

QUINN AND COMPANY, INC.
(8-14364)

JOHN DORNACKER

ORDER SUSPENDING MEMBERSHIP IN NATIONAL SECURITIES ASSOCIATION AND ASSOCIATION WITH BROKER-DEALER

Proceedings having been instituted pursuant to Sections 15(b), 15A and 19(a) (3) of the Securities Exchange Act of 1934 to determine what, if any, remedial action is appropriate in the public interest with respect to, among others, Quinn and Company, Inc. and John Dornacker;

A stipulation having been entered into whereby a hearing before a hearing examiner and a hearing examiner's initial decision were waived, and briefs having been filed with the Commission;

The Commission having this day issued its Findings and Opinion; on the basis of said Findings and Opinion

IT IS ORDERED that Quinn and Company, Inc. be, and it hereby is, suspended for a period of 15 calendar days from membership in the National Association of

Appendix B

Securities Dealers, Inc., and that John Dornacker be, and he hereby is, suspended from associating with any broker or dealer for a period of 20 calendar days, such suspensions to commence at the opening of business on February 1, 1971.

By the Commission.

Orval L. DuBois
Secretary

APPENDIX C

Federal Statutes, Rules and Regulations Involved

Securities Act of 1933, 15 U.S.C. § 77a *et seq.*
Sections 2(3), (11)-(12), 15 U.S.C. §§ 77b(3), (11)-(12)

Section 2. When used in this title, unless the context otherwise requires—

* * *

(3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell", "offer for sale", or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. The terms defined in this paragraph and the term "offer to buy" as used in subsection (c) of section 5 shall not include preliminary negotiations or agreements between an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer) and any underwriter or among underwriters who are or are to be in privity of contract with an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer). Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been offered and sold for value. The issue or transfer of a right or privilege, when originally issued or transferred with a security, giving the holder of such security the right to convert such security into another security

of the same issuer or of another person, or giving a right to subscribe to another security of the same issuer or of another person, which right cannot be exercised until some future date, shall not be deemed to be an offer or sale of such other security; but the issue or transfer of such other security upon the exercise of such right of conversion or subscription shall be deemed a sale of such other security.

* * *

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(12) The term "dealer" means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.

* * *

Section 3(a)(9), 15 U.S.C. § 77c(a)(9)

SECTION 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * *

Appendix C

(9) Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange;

* * *

Sections 4(1), (3)-(4), 15 U.S.C. §§ 77d(1), (3)-(4)

SECTION 4. The provisions of section 5 shall not apply to—

(1) transactions by any person other than an issuer, underwriter, or dealer.

* * *

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except—

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

* * *

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions executed upon customers'

orders on any exchange or in the over-the-counter market but not the solicitation of such orders.

Sections 5(a), (c), 15 U.S.C. §§ 77e(a), (c)

SECTION 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order to stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

Section 6(a), 15 U.S.C. § 77f(a)

SECTION 6. (a) Any security may be registered with the Commission under the terms and conditions hereinafter provided, by filing a registration statement in triplicate, at least one of which shall be signed by each issuer, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting

officer, and the majority of its board of directors or persons performing similar functions (or, if there is no board of directors or persons performing similar functions, by the majority of the persons or board having the power of management of the issuer), and in case the issuer is a foreign or Territorial person by its duly authorized representative in the United States; except that when such registration statement relates to a security issued by a foreign government, or political subdivision thereof, it need be signed only by the underwriter of such security. Signatures of all such persons when written on the said registration statements shall be presumed to have been so written by authority of the person whose signature is so affixed and the burden of proof, in the event such authority shall be denied, shall be upon the party denying the same. The affixing of any signature without the authority of the purported signer shall constitute a violation of this title. A registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered.

* * *

Section 17(a), 15 U.S.C. § 77q(a)

SECTION 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the cir-

cumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

* * *

Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*

Section 10(b), 15 U.S.C. § 78j(b)

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Sections 15 (b)(1)-(10), 15 U.S.C. § 78o(b)(1)-(10)

SECTION 15.

* * *

(b) (1) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any persons associated with such broker or dealer as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided,

such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

(2) An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person associated with the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as its own.

(3) If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date of the registration, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

(4) Any provision of this title (other than section 5 and subsection (a) of this section) which prohibits any act, practice, or course of business if the mails or any

means or instrumentality of interstate commerce are used in connection therewith shall also prohibit any such act, practice, or course of business by any broker or dealer registered pursuant to this subsection or any person acting on behalf of such a broker or dealer, irrespective of any use of the mails or any means or instrumentality of interstate commerce in connection therewith.

(5) The Commission shall, after appropriate notice and opportunity for hearing, by order censure, deny registration to, suspend for a period not exceeding twelve months, or revoke the registration of, any broker or dealer if it finds that such censure, denial, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated—

(A) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.

(B) has been convicted within ten years preceding the filing of the application or at any time thereafter of any felony or misdemeanor which the Commission finds—

(i) involves the purchase or sale of any security.

(ii) arises out of the conduct of the business of a broker, dealer, or investment adviser.

(iii) involves embezzlement, fraudulent conversion, or misappropriation of funds or securities.

(iv) involves the violation of section 1341, 1342, or 1343 of title 18, United States Code.

(C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(D) has willfully violated any provision of the Securities Act of 1933, or of the Investment Advisers Act of 1940, or of the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes.

(E) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or the Investment Advisers Act of 1940, or the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this clause (E) no person shall be deemed to have failed reasonably to supervise any person, if—

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(F) is subject to an order of the Commission entered pursuant to paragraph (7) of this subsection (b) barring or suspending the right of such person to be associated with a broker or dealer, which order is in effect with respect to such person.

(6) Pending final determination whether any registration under this subsection shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing (which may consist solely of affidavits and oral arguments), it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in

the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in existence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

(7) The Commission may, after appropriate notice and opportunity for hearing, by order censure any person, or bar or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer, if the Commission finds that such censure, barring, or suspension is in the public interest and that such person has committed or omitted any act or omission enumerated in clause (A), (D) or (E) of paragraph (5) of this subsection or has been convicted of any offense specified in clause (B) of said paragraph (5) within ten years of the commencement of the proceedings under this paragraph or is enjoined from any action, conduct, or practice specified in clause (C) of said paragraph (5). It shall be unlawful for any person as to whom such an order barring or suspending him from being associated with a broker or dealer is in effect, willfully to become, or to be, associated with a broker or dealer, without the consent of the Commission, and it shall be unlawful for any broker or dealer to permit such a person to become, or remain, a person associated with him, without the consent of the Commission, if such broker or dealer knew, or in the exercise of reasonable care, should have known, of such order.

(8) No broker or dealer registered under section 15 of this title shall, during any period when it is not a member of a securities association registered with the Commission under section 15A of this title, effect any transac-

tion in, or induce the purchase or sale of, any security (otherwise than on a national securities exchange) unless such broker or dealer and all natural persons associated with such broker or dealer meet such specified and appropriate standards with respect to training, experience, and such other qualifications as the Commission finds necessary or desirable. The Commission shall establish such standards by rules and regulations, which may—

(A) appropriately classify brokers and dealers and persons associated with brokers and dealers (taking into account relevant matters, including types of business done and nature of securities sold).

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules and regulations.

(D) provide that persons in any such class other than a broker or a dealer and partners, officers, and supervisory employees (which latter term may be defined by the Commission's rules and regulations and as so defined shall include branch managers of brokers or dealers) of brokers or dealers, may be qualified solely on the basis of compliance with such specified standards of training and such other qualifications as the Commission finds appropriate.

The Commission may prescribe by rules and regulations reasonable fees and charges to defray its costs in carrying out this paragraph, including, but not limited to, fees for any examination administered by it, or under its direction. The Commission may cooperate with securities associations registered under section 15A of this title and

with national securities exchanges in administering examinations and may require brokers and dealers subject to this paragraph and persons associated with such brokers and dealers to pass examinations administered by or on behalf of any such association or exchange and to pay to such association or exchange reasonable fees or charges to defray the costs incurred by such association or exchange in administering such examinations.

(9) In addition to the fees and charges authorized by paragraph (8), each broker or dealer registered under section 15 of this title not a member of a securities association registered pursuant to section 15A of this title shall pay to the Commission such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such broker or dealer is not a member of such a securities association. The Commission shall establish such fees and charges by rules and regulations.

(10) No broker or dealer subject to paragraph (8) of this subsection shall effect any transaction in, or induce the purchase or sale of, any security (otherwise than on a national securities exchange) in contravention of such rules and regulations as the Commission may prescribe designed to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market.

* * *

Appendix C

Sections 15A(*l*)(1)-(3), 15 U.S.C. §§ 78o-3(*l*)(1)-(3)

SECTION 15A.

* * *

(*l*) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding 12 months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulaton thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section.

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person—

(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder.

(B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe,

was willfully violating with respect to such transaction any provision of such Act or rule or regulation.

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

* * *

Section 19(a)(3), 15 U.S.C. § 78s(a)(3)

SECTION 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

* * *

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

* * *

Section 25(a), 15 U.S.C. § 78y(a)

SECTION 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order,

a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification . . . .

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Appendix C

28 U.S.C. § 1254(1)

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

* * *